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RAHMAN'S CHAMBER
Barristers & Advocates

Alam Tower, 3rd Floor
12, DIT Avenue (East)
Motijheel Commercial Area
Dhaka-1000.
Ph.:(+8802)7171251
(+88)06662611757
Fax:(+8802)7170815
email: info@rahmansc.com
web: www.rahmansc.com

The Role of Non-Bank Financial Institutions in the Growth of New Entrepreneurs

Forrukh Rahman*

The Financial Institutions Act 1993("FIA") defines financial institutions ("FI") as the non-banking institutions, which give loans or advances, invest in shares, stocks etc., carries on business of hire purchase transactions, venture capital etc. The policy behind creation of FI was to encourage lease finance or long term loan to facilitate the rapid growth of the manufacturing sectors in the country. An attempt is made below to evaluate the role of FIs in the growth of new Entrepreneurs.

Number of FI

There are 28 FIs in Bangladesh at present. It is highly critised as out-numbered because a very few of them are actually financing in venture capital. Profit oriented small FIs fail to manage huge capital required for the risky and challenging investment. They don't have the surplus fund required for investing in risky business. This is partly responsible for slow rate of emergence of new entrepreneurs. Many of the FIs are involved in small lease financing.

Banks vs. FI

Under FIA, no FI are allowed to accept any deposit payable on demand by cheque, draft etc. or deal in gold or foreign exchange etc. Therefore, FI do not have short term liabilities. On the other hand, the Bank Company Act 1991 authorises the Banks to do leasing business, therefore, allowing them to enter into the business of long term finance. Whereas banks are accepting short-term deposit and most of their liabilities are short term. There seems to be a mismatch. However, the Banks are managing to provide long term finance due to their capital strength.

Although financing in term loan demands different treatment from financing in working capital. In the latter case, it is the business risk, which is shared by the lender. Merely relying on security documents is not enough. Assessing the viability of the project and also the skill of the persons involved are very important. Further, it is the relationship, which is akin to partnership, exists between the lender and businessmen. The above features are present with FIs rather than with Banks as they do not manage short terms deposits and are easily accessible, quick and specialized for term lending. However, the FIs are facing difficulty to compete with Banks due to their capital scarcity.

High Interest Rate

In order to encourage manufacturing business in Bangladesh by facilitating the growth of new entrepreneurs, it is important to create such intermediaries who can finance at lower rate of interest. High interest rate means higher risk in borrowing. Businessmen can not effort to invest in such projects where the return will take longer time than the usual. Therefore, no venture capitalist can emerge. The borrowing rates from FIs are often higher than Banks since many a times they arrange their capital by borrowing from Banks.

Weak Capital Market

As stated above, FIs borrow heavily from the banks. Banks are paying loan to FIs at the same rate or even in higher rate then their regular customer. The cost of fund is therefore high. The capital market can be an alternative for low cost capital. However, the capital available from that market carries with it the high level of expectation. There is the pressure of being profitable from year one and paying dividend. This does not help in reducing interest rate and investing in new entrepreneurs and/or manufacturing sectors.

Under the direction of Bangladesh Bank the FIs are at present floating share in capital market to raise fund. It would not produce any good result until and unless the FIs manage to invest in manufacturing sector with low rate of interest.

Professionalism

There is a tendency among the sponsor shareholders of FIs to consider the financing business as their family business. The composition of the Board of Directors of many FIs suggests that it is not run by the professionals, who are skilled in the finance business.

The FIs should encourage and welcome professionals as independent directors in the Board. This will improve corporate governance and the quality of the decisions of the Board.

Portfolio Management

The existing laws and regulations are silent about allocation of fund for financing in different business sector by FIs. The country seriously suffers from lack of manufacturing. In the absence of regulatory support through reputed FIs, the growth of manufacturing can not be helped.

Branch Office

All FIs are having 99% of their business concentrated in Dhaka. They are opening new branches in Dhaka and generally not willing to go outside. Some regulatory support may be required in this regard.

Reserve and Liquid Fund

Every FI is under the obligation to maintain a reserve fund and liquid assets. It seems that same policy is framed for both banks and FIs. Since FIs do not accept short term deposits, the obligation may be relaxed further.

Conclusion

The FIA empowers Bangladesh Bank to issue directions. Further under FIA, Bangladesh Bank has power to inspect the FI, seek compliance of return by FIs, place the FIs under moratorium, impose penalties and generally regulate the FIs. Bangladesh Bank can determine the following matters: (a) maximum rates of interest on deposit (b) maximum limit of deposit (c) maximum repayment periods (d) maximum rates of interest on loan (e) maximum amount of loan (f) reserve to be maintained by FIs in Bangladesh Bank (g) any other matter in public interest.

It is submitted that different policy support and regulation is required for FIs from that of Banks. The regulation should ensure availability of fund for the good manufacturer at low rate of interest. This may be achieved by encouraging merger and amalgamation, reducing rate of inflation, raising capital from capital market and regulating lending portfolio of FIs. Policy support should be available for honest venture capitalists. Corporate governance of the FIs may be increased by placing minimum number expert independent directors in the Board and increasing the number of directors required for fulfilling the quorum.

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* Barrister-at-Law ; Advocate, Supreme Court of Bangaldesh